

ECONOMIC OUTLOOK AND REVENUE ESTIMATES FOR MICHIGAN

**FY 2005-06
AND
FY 2006-07**



Mitchell E. Bean, Director

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FOREWORD

The House Fiscal Agency (HFA) is pleased to provide this report to members of the Michigan House of Representatives. The report presents final General Fund/General Purpose and School Aid Fund revenue estimates for fiscal year (FY) 2004-05, and revised revenue estimates for FY 2005-06 and FY 2006-07. Estimates reported herein will be presented to the Consensus Revenue Estimating Conference on May 17, 2006, and will be used to facilitate the consensus estimating process.

This report includes HFA analyses of important factors that will affect state and national economies through the year 2007, estimates of the Countercyclical Budget Stabilization Fund, state compliance with the Constitutional State Revenue Limit, and year-end balance estimates for General Fund/General Purpose (GF/GP) and the School Aid Fund (SAF).

Rebecca Ross, Senior Economist, and Jim Stansell, Economist, are the authors of this report. Jeanne Dee prepared the report for publication.

TABLE OF CONTENTS

Executive Summary	1
U.S. Forecast	1
Michigan Forecast	1
Table 1: HFA Revenue Estimates	3
Table 2: FY 2005-06 HFA Recommended Revisions.....	3
Table 3: FY 2006-07 HFA Recommended Revisions.....	3
 Economic Review and Forecast	 5
Total Non-Farm Employment (Figure 1).....	5
U.S. and Michigan Employment (Figure 2)	6
Institute for Supply Management (ISM) Index (Figure 3)	7
Index of Consumer Sentiment (Figure 4).....	7
Real GDP (Figure 5)	8
Light Vehicle Sales (Figure 6)	9
Inflation.....	10
Income Growth (Figure 7).....	10
Employment (Figure 8)	11
Unemployment.....	12
Table 4: Economic Forecast Variables	14
 Risks and Uncertainties	 15
 GF/GP and SAF Revenue	 17
GF/GP Revenue by Source	17
SAF Revenue by Source	17
Table 5: GF/GP Revenue Estimates	18
Table 6: School Aid Fund Revenue Estimates	18
HFA Estimates of Year-End Balances.....	19
Table 7: Year-End Balance Estimates.....	19
BSF Year-End Balance (Table 8, Figure 9)	19
Compliance With State Revenue Limit (Tables 9 and 10, Figure 10)	21



EXECUTIVE SUMMARY

The national economy posted weak growth beginning late in calendar year (CY) 2001 and continuing through CY 2002 and early CY 2003. Output growth acceleration began late in CY 2003 and continued through CY 2004 and CY 2005. In conjunction with the strong output growth, there was an increase in employment. National nonfarm employment grew 1.4% in CY 2004 and 2.0% in CY 2005.

Michigan's wage and salary employment has generally trended downward since mid-2000. In the first quarter of 2006, Michigan's wage and salary employment declined by 19,800 workers. Over the past year, Michigan lost an average of 1,900 jobs per month.

U. S. Forecast

Real GDP growth is forecast to increase 3.4% in CY 2006, down slightly from 3.5% in CY 2005. Real GDP is forecast to slow to 2.7% in CY 2007.

Inflation, as measured by the Consumer Price Index (CPI), is forecast to decline from 3.4% in CY 2005 to 3.2% in CY 2006 and 2.6% in CY 2007.

Light vehicle sales totaled 16.9 million units in both CY 2004 and CY 2005 and are forecast to drop to 16.7 million in CY 2006 before rising back to 16.8 million units in CY 2007. The import share of light vehicles is forecast to be 22.0% in both CY 2006 and CY 2007.

The national unemployment rate, which was 5.1% in CY 2005, is forecast to decrease to 4.8% in CY 2006 and 4.9% in CY 2007.

Interest rates on three-month T-bills averaged 3.1% in CY 2005; rates are forecast to increase to 4.7% in CY 2006 and 4.9% in CY 2007.

Michigan Forecast

Michigan personal income increased 3.4% in CY 2005; the rate of growth is expected to increase 3.8% in CY 2006 and 4.2% in CY 2007.

Michigan's unemployment rate was 6.7% in CY 2005 and is forecast to be 6.8% in CY 2006 and 7.5% in CY 2007.

Inflation, as measured by the Detroit Consumer Price Index, was 2.9% in CY 2005; it is forecast to accelerate to 3.4% in CY 2006, then decelerate to 2.4% in CY 2007.

State Revenue

Final total baseline GF/GP and SAF revenue was \$19.1 billion in FY 2004-05, and is forecast to increase 2.2% to \$19.5 billion in FY 2005-06 and 2.4% to \$20.0 billion in FY 2006-07.

Baseline revenue does not include the impact of partial-year policy changes or certain policy changes that have only recently occurred. Baseline estimates are comparable across fiscal years and demonstrate the changes to state revenue that are driven by changes in the economy.

Final total actual GF/GP and SAF revenue was \$19.2 billion in FY 2004-05; it is forecast to increase \$288.4 million (1.5%) in FY 2005-06 and \$439.0 million (2.3%) to \$19.9 billion in FY 2006-07. Actual revenue captures the effects of all policy changes and represents resources available.

Table 1 reports GF/GP and SAF revenue in terms of baseline and actual revenue. House Fiscal Agency's recommended revisions to estimates for FY 2005-06 and FY 2006-07 are reported in **Table 2** and **Table 3**.

State Revenue Limit

Final total state revenue is expected to be below the state revenue limit by \$4.2 billion in FY 2004-05; it is estimated to be under the limit by \$4.8 billion in FY 2005-06 and \$5.3 billion in FY 2006-07. Final calculation of the state revenue limit is performed by the Auditor General.

Fund Balances

Beginning GF/GP balance is estimated to be \$220.5 million for FY 2005-06.

Beginning School Aid Fund balance is estimated to be \$98.0 million for FY 2005-06.

Beginning Countercyclical Budget Stabilization Fund balance is estimated to be \$2.0 million for FY 2005-06 and zero for FY 2006-07.

Table 1
HFA REVENUE ESTIMATES
(Millions of Dollars)

	<u>Final</u> <u>FY 2004-05</u>	<u>HFA Estimate</u> <u>FY 2005-06</u>	<u>HFA Estimate</u> <u>FY 2006-07</u>
Baseline GF/GP	\$8,163.4	\$8,319.1	\$8,458.6
Baseline SAF	<u>10,914.7</u>	<u>11,180.8</u>	<u>11,512.8</u>
TOTAL BASELINE	\$19,078.1	\$19,500.0	\$19,971.4
Actual GF/GP	\$8,298.9	\$8,290.6	\$8,399.7
Actual SAF	<u>10,909.7</u>	<u>11,206.3</u>	<u>11,536.3</u>
TOTAL ACTUAL	\$19,208.6	\$19,497.0	\$19,936.0

NOTE: Numbers may not add due to rounding.

Table 2
FY 2005-06 HFA RECOMMENDED REVISIONS
(Millions of Dollars)

	<u>January 2006</u> <u>Consensus</u>	<u>May 2006</u> <u>Recommendation</u>	<u>HFA Recommended</u> <u>Revision</u>
Baseline GF/GP	\$8,247.2	\$8,319.1	\$71.9
Baseline SAF	<u>11,205.4</u>	<u>11,180.8</u>	<u>(24.6)</u>
TOTAL BASELINE	\$19,452.6	\$19,500.0	\$47.4
Actual GF/GP	\$8,207.8	\$8,290.6	\$82.8
Actual SAF	<u>11,230.9</u>	<u>11,206.3</u>	<u>(24.6)</u>
TOTAL ACTUAL	\$19,438.7	\$19,497.0	\$58.2

NOTE: Numbers may not add due to rounding.

Table 3
FY 2006-07 HFA RECOMMENDED REVISIONS
(Millions of Dollars)

	<u>January 2006</u> <u>Consensus</u>	<u>May 2006</u> <u>Recommendation</u>	<u>HFA Recommended</u> <u>Revision</u>
Baseline GF/GP	\$8,436.0	\$8,458.6	\$22.6
Baseline SAF	<u>11,567.5</u>	<u>11,512.8</u>	<u>(54.7)</u>
TOTAL BASELINE	\$20,003.5	\$19,971.4	(\$32.1)
Actual GF/GP	\$8,377.2	\$8,399.7	\$22.5
Actual SAF	<u>11,591.1</u>	<u>11,536.3</u>	<u>(54.8)</u>
TOTAL ACTUAL	\$19,968.2	\$19,936.0	(\$32.3)

NOTE: Numbers may not add due to rounding.



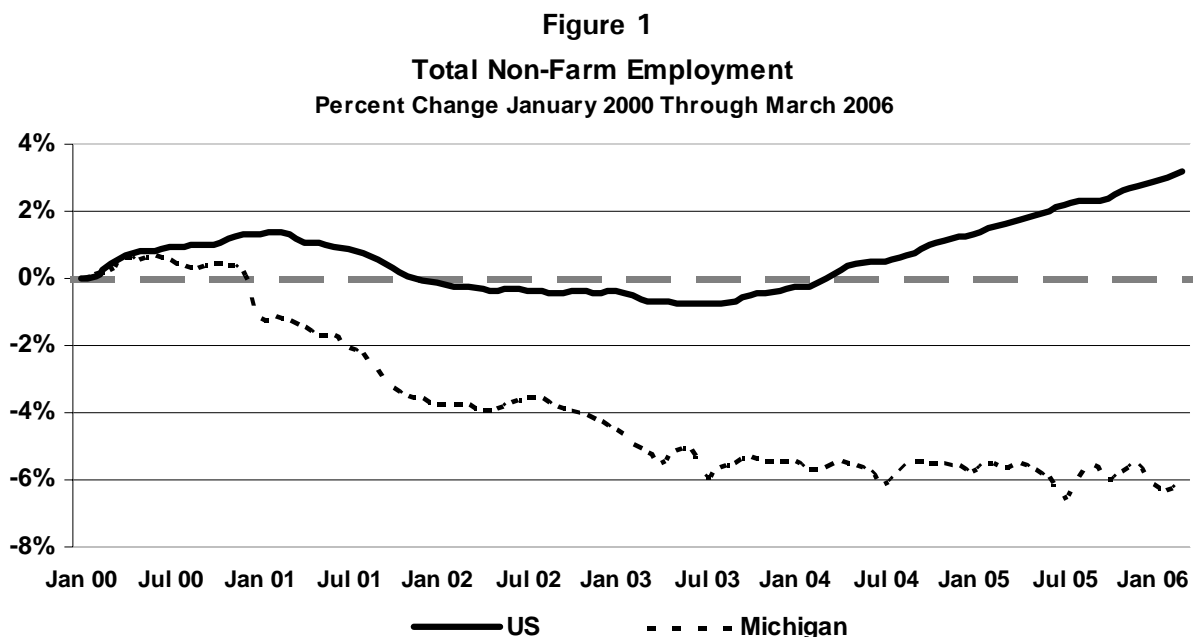
ECONOMIC REVIEW AND FORECAST

This section presents the economic forecast used by the House Fiscal Agency to produce its revenue forecasts for FY 2005-06 and FY 2006-07.

The eight-month national recession that ended in November 2001 was followed by weak economic growth throughout CY 2002 and the early part of CY 2003. At the national level, economic growth accelerated at the end of CY 2003 and continued through CY 2005. Job growth at the national level began to improve during the latter half of CY 2003, and has continued its upward trend.

Total Non-Farm Employment

Figure 1 shows the monthly percent change in total non-farm employment for both the U.S. and Michigan from January 2000 through March 2006.



U.S. Non-Farm Employment

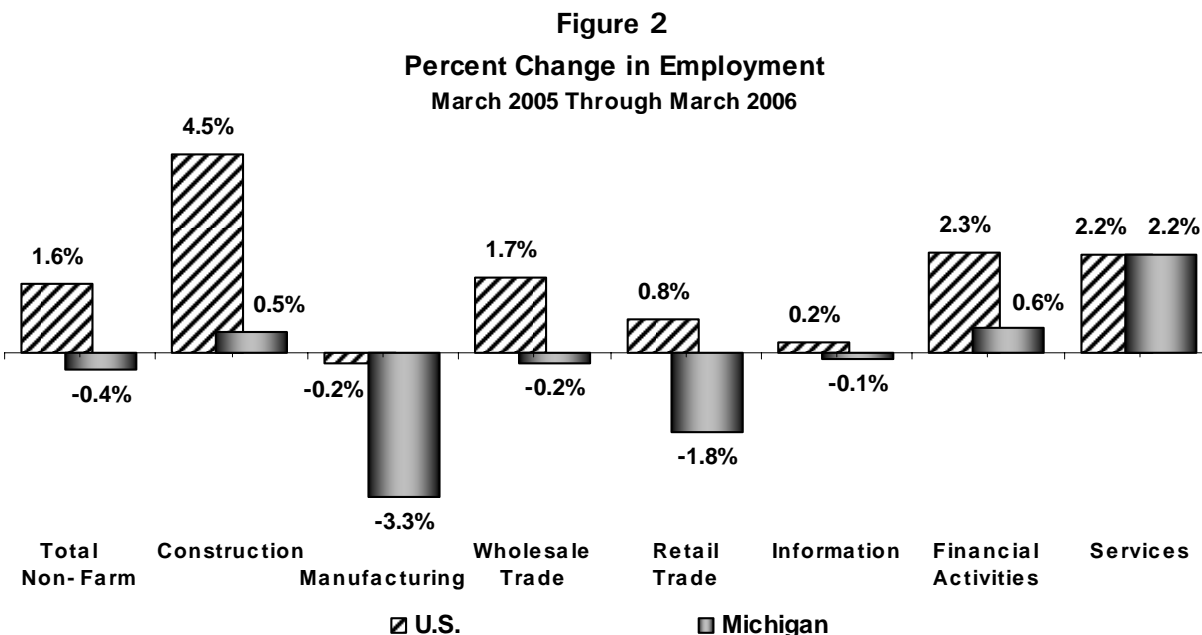
Employment in the U.S. reached a peak in February 2001, and began a long slide that did not end until May 2003. During this 29-month period, the national economy lost more than 2.7 million jobs, or about 100,700 jobs per month on average. In the 34 months since May 2003, more than five million jobs have been added.

Michigan Non-Farm Employment

Although employment has rebounded at the national level, conditions in Michigan are far less optimistic. Employment in Michigan peaked in June 2000, a full eight months before the national level peak in February 2001. Following the June 2000 peak, employment in Michigan dropped steadily until July 2003, resulting in a loss of more than 314,000 jobs—a 6.7% decline. Since then, employment in Michigan has fluctuated around the July 2003 level, with monthly job gains offset by subsequent monthly job losses. Between July 2003 and March 2006, more than 10,000 additional jobs have been lost.

U.S. and Michigan Employment

Figure 2 shows the percentage change in employment over the past year for all private workers and several important sectors of the economy for both the U.S. and Michigan. Although the U.S. gained almost two million jobs over this period, employment in Michigan fell by almost 23,000 jobs.



U.S. Employment

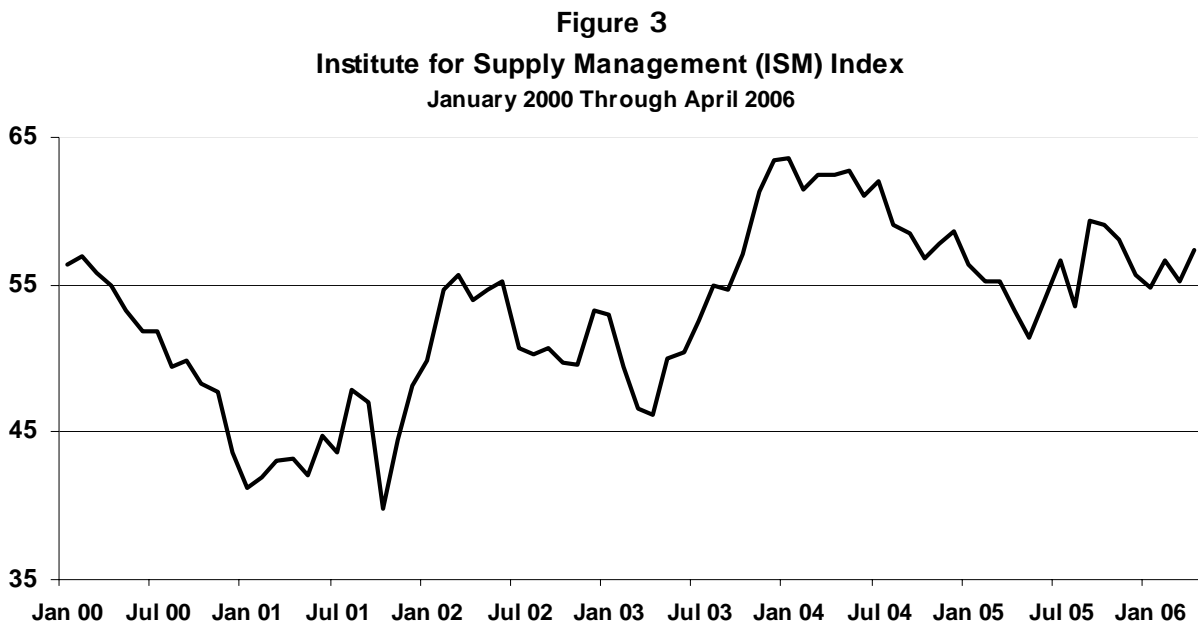
From March 2005 through March 2006, the U.S. experienced job gains in all sectors except manufacturing, which shed about 35,000 jobs. These job losses were more than offset by gains in all other sectors. The construction, financial activities, and service sectors all experienced employment growth in excess of 2%.

Michigan Employment

Job losses in Michigan over the past year were concentrated in the manufacturing and retail trade sectors, although the wholesale trade and information sectors also experienced declining employment. Approximately 22,300 manufacturing jobs were lost during this time period—more than 60% of the total nationwide decline in manufacturing employment.

Institute for Supply Management (ISM) Index

Figure 3 shows the ISM Index, a composite index of five economic indicators used to measure economic vitality beginning with January 2000. An index number above 50 indicates a growing manufacturing sector; a number below 50 suggests that the manufacturing sector is contracting.



The index in January 2000 was 56.3; it then fell below 50 in August 2000 and remained below 50 until February 2002. After peaking in June 2002, the index began to drop, and by October it had fallen back below 50—where it remained before jumping to 53.3 in December.

The ISM index dropped during each of the first four months of 2003, then began a strong rebound that led to a 20-year high of 63.3 in January 2004. Although a 16-month slide saw the index decline to a level of 51.4 in May 2005, it rose in three of the next four months before beginning a four-month decline to 54.8 in January. The index was 57.3 in April 2006.

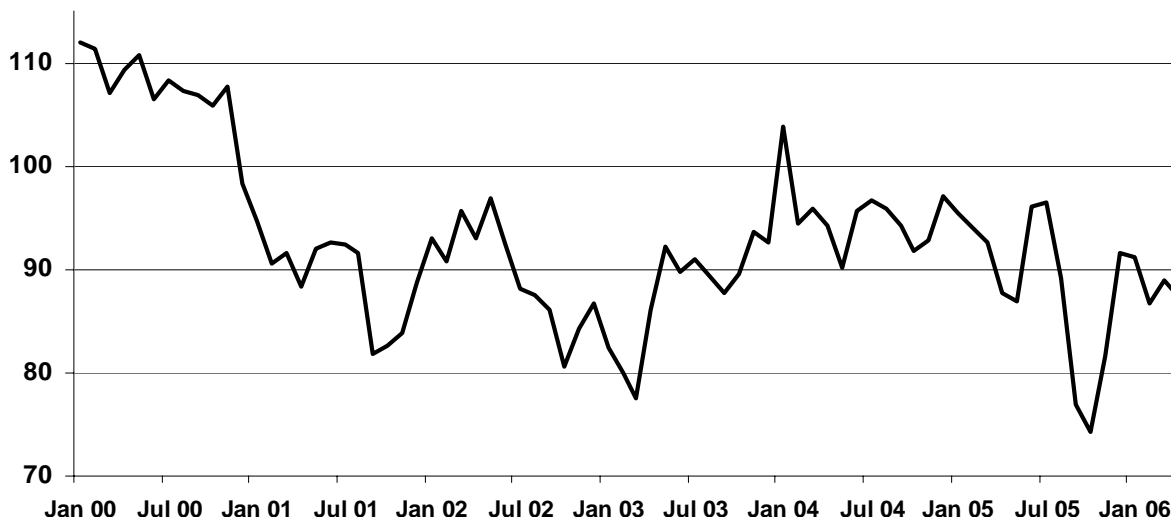
Index of Consumer Sentiment

Consumer sentiment can be a strong motivator of personal consumption expenditures, which represent almost two-thirds of GDP. **Figure 4** shows the University of Michigan Index of Consumer Sentiment, with a pattern similar to that of the ISM index.

Even though the ISM index began to fall in early 2000, consumers remained cautiously optimistic about the economy. The consumer sentiment index remained at historically-high levels throughout most of CY 2000, but dropped in December 2000 and continued falling until February 2001. Like the ISM index, consumer sentiment rebounded somewhat through August 2001 before plunging again in September 2001.

Figure 4

University of Michigan Index of Consumer Sentiment
January 2000 Through April 2006



The index of consumer sentiment began 2003 with a three-month drop before rebounding in April and May. For the remainder of the year, the index generally followed an upward trend comprised of small monthly changes.

After a large spike in January 2004 brought the index to over 100 for the first time in more than three years, it immediately dropped back in February and remained in the low-to mid-90s before ending 2004 with two consecutive monthly increases. Following this brief uptick, consumer sentiment declined in each of the next five months due, in part, to concerns about high gas prices and the possibility that the economy may be weakening.

In the wake of hurricanes Katrina and Rita in 2005, the index plunged to 72.4 in October before rising to a level of 91.5 in December. It has since dropped in three of the past four months to its current level of 87.4, as consumers expressed concerns over rising gas prices and interest rates.

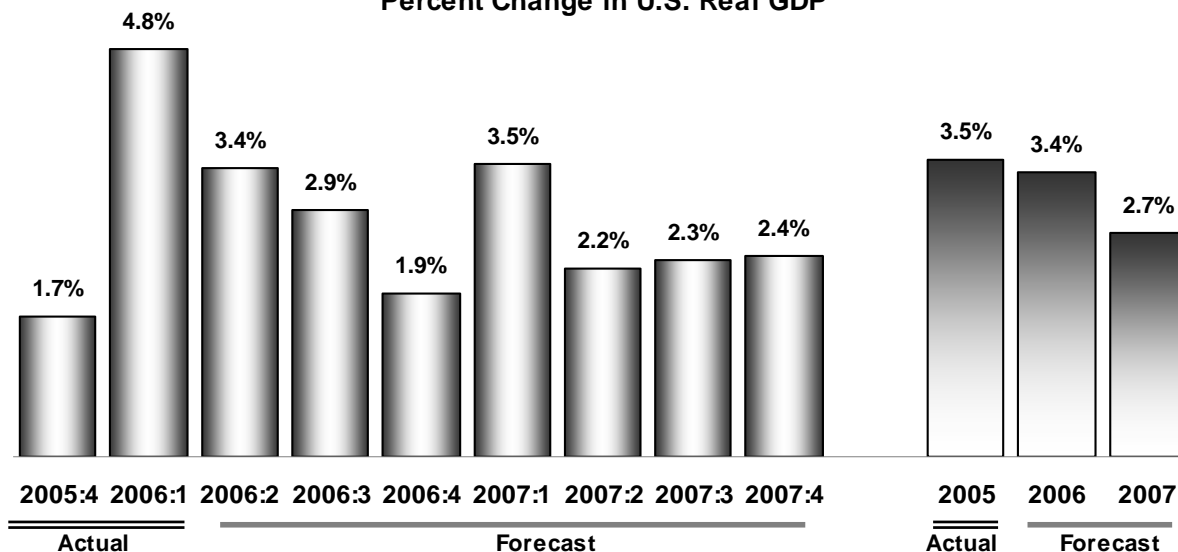
Real GDP

Figure 5 shows the estimated percent change in U.S. Real GDP for CY 2005, CY 2006, and CY 2007.

After rising 4.8% during the first quarter of 2006, real GDP growth is anticipated to slow to 3.4% in the second quarter, and drop to just 1.9% by the fourth quarter of 2006. Real GDP growth, which was 3.5% in CY 2005, is forecast to be 3.4% in CY 2006 and 2.7% in CY 2007.

GDP growth continues to be fueled primarily by business investment. Gross private domestic investment is forecast to increase 7.4% in CY 2006 and 6.1% in CY 2007, which should more than offset projected declines in residential construction in CY 2007.

Figure 5
Percent Change in U.S. Real GDP

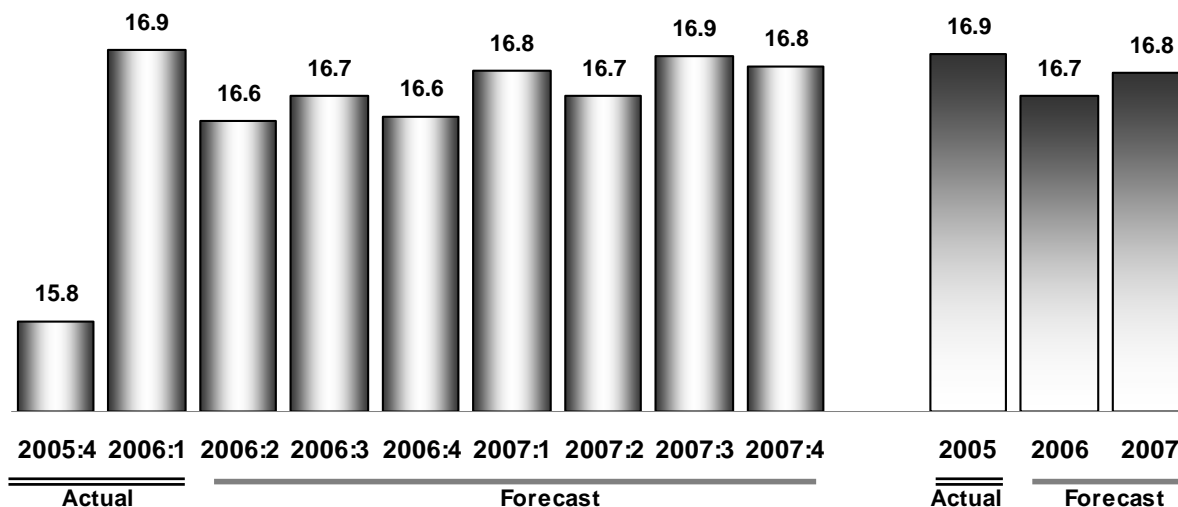


Personal consumption advanced 3.5% during CY 2005. As the economy begins to slow down, growth in personal consumption is predicted to remain at 3.5% in CY 2006 and 3.3% in CY 2007.

Light Vehicle Sales

Figure 6 shows light vehicle sales for CY 2005 and estimated sales for CY 2006 and CY 2007.

Figure 6
Light Vehicle Sales
(Millions of Units)



Sales of light motor vehicles in CY 2005 totaled 16.9 million units—well below the CY 2000 record level of 17.2 million units. Light vehicle sales are anticipated to total 16.7 million units in CY 2006 and 16.8 million units in CY 2007.

There has been a shift in sales away from light trucks and toward cars over the past two years. The share of light trucks is expected to continue declining in CY 2006 before stabilizing in CY 2007. Light truck sales, which accounted for just under 56.0% of total sales in CY 2004, declined to 54.6% in CY 2005, and are expected to decline to 52.5% in CY 2006 and 52.3% in CY 2007.

The import share of total light vehicle sales was 20.1% in CY 2005; it is forecast to increase slightly to 22.0% in both CY 2006 and CY 2007.

Inflation

U.S. Inflation

Although the overall increase in some input prices (e.g., wages and import prices) has generally remained moderate and helped hold down production costs, increasing crude oil and natural gas prices could significantly impact almost all sectors of the economy.

Benchmark West Texas intermediate crude, which averaged just over \$41 per barrel in CY 2004, began 2005 near \$47 per barrel, and reached a high of almost \$65 per barrel in September following hurricanes Katrina and Rita. Continued concern over the stability of the oil supply and increased world demand have caused oil prices to level off near \$70 per barrel, 33% higher than one year ago. It is anticipated that oil prices will drop very slightly throughout the forecast period and average about \$67 per barrel during CY 2006 and \$64 per barrel in CY 2007.

The annual rate of inflation, as measured by the percentage change in the U.S. Consumer Price Index-Urban (CPI-U), was 3.4% in CY 2005; it is expected to drop to 3.2% in CY 2006 and 2.6% in CY 2007.

Michigan Inflation

The cost of living in Michigan is measured by the Detroit Consumer Price Index for Urban Consumers (Detroit CPI-U). Michigan's average inflation rate was 2.9% in CY 2005. Inflation in Michigan should remain relatively low throughout the forecast period. The Detroit CPI-U is expected to increase by 3.4% in CY 2006 and 2.4% in CY 2007.

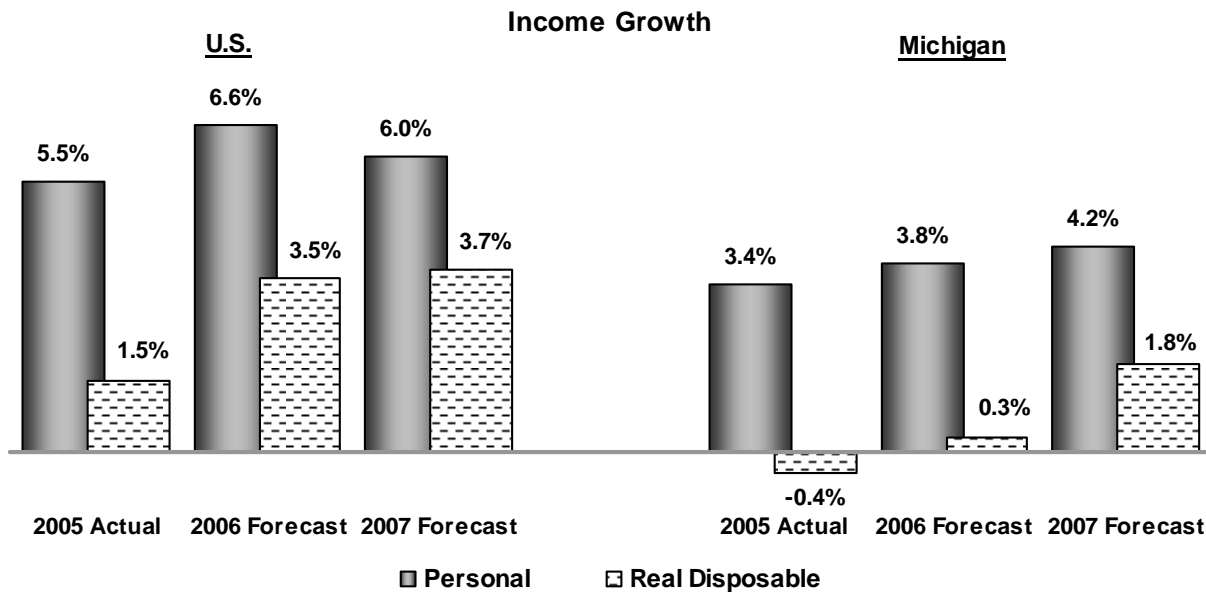
Income Growth

Figure 7 shows personal and real disposable income growth for the U.S. and for Michigan.

U.S. Income Growth

Total U.S. personal income grew by 5.5% in CY 2005. Personal income growth is forecast to increase 6.6% in CY 2006 and 6.0% in CY 2007.

Figure 7



Slightly higher inflation contributed to a modest 1.5% growth of U.S. real disposable income in CY 2005. It is forecast that U.S. real disposable income will grow by 3.5% in CY 2006 and 3.7% in CY 2007.

Michigan Income Growth

Michigan's total state personal income growth was 3.4% in CY 2004. Michigan personal income is forecast to increase 3.8% in CY 2006 and 4.2% in CY 2007.

Michigan real disposable income declined 0.4% in CY 2005; it is forecast to grow 0.3% in CY 2006 and 1.8% in CY 2007.

Employment

Figure 8 shows Michigan wage and salary, manufacturing, and private non-manufacturing employment growth.

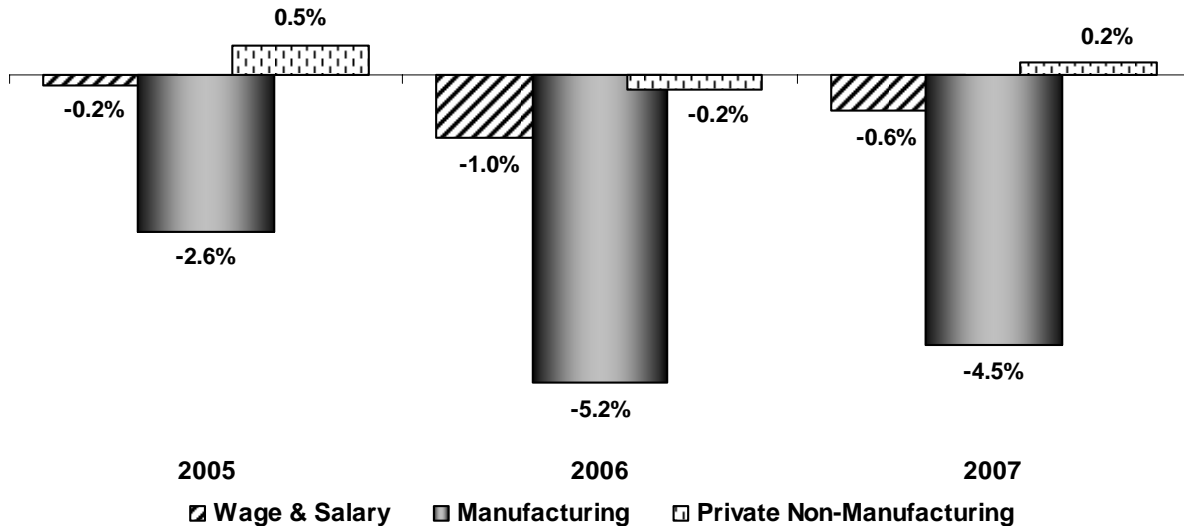
U.S. Employment

One critical factor underscoring the difference in income growth between the U.S. and Michigan is overall job growth. Nationally, total non-farm employment posted average gains of almost 170,000 per month during 2005, a 1.5% overall growth rate. Total non-farm employment is projected to increase by 1.4% in CY 2006 before growing by just 1.2% in CY 2007 as the economy begins to slow.

Michigan Employment

The Michigan economy has continued to endure a weak labor market; wage and salary employment declined by about 7,800 workers in CY 2005 and is estimated to decline by almost 45,000 workers in CY 2006 and 26,000 workers in CY 2007. The forecast calls for continued quarterly job losses through the end of CY 2007.

Figure 8
Michigan Employment Growth



Michigan wage and salary employment fell 0.2% in CY 2005, and is forecast to fall 1.0% in CY 2006 and 0.6% in CY 2007. Over the past 25 years, Michigan wage and salary employment has grown at an average annual rate of about 1.0%.

Michigan manufacturing employment dropped 2.6% in CY 2005, and is forecast to decrease 5.2% in CY 2006 and 4.5% in CY 2007. Although the most significant declines are concentrated in the motor vehicle industry, employment declines also appear throughout the entire manufacturing sector.

Michigan private non-manufacturing employment rose a modest 0.5% in CY 2005; it is expected to drop 0.2% in CY 2006 before growing 0.2% in CY 2007.

Unemployment

U.S. Unemployment

As of March 2006, total non-farm employment increased in each of the past 34 months, which has helped to hold down the unemployment rate. Although much of this growth has been in service-providing sectors, the goods-producing sector has also experienced growth during the past year. Only the manufacturing sector continues to shed jobs.

The U.S. unemployment rate was 5.1% in CY 2005; it is forecast to drop to 4.8% in CY 2006 before rising slightly to 4.9% in CY 2007.

Michigan Unemployment

Employment in Michigan remains a major concern as employment growth has fallen during each of the past five years. Michigan's wage and salary employment is forecast to continue declining throughout 2006 and 2007. As a result, the

unemployment rate is expected to remain relatively high through 2007 as increases in the labor force (and unemployment) more than offset any employment gains.

Michigan's unemployment rate was 6.7% in CY 2005, and is expected to rise to 6.8% in CY 2006 and 7.5% in CY 2007.

Table 4
ECONOMIC FORECAST VARIABLES

	<u>Calendar 2004 Actual</u>	<u>Calendar 2005 Estimated</u>	<u>% Change from Prior Year</u>	<u>Calendar 2006 Estimated</u>	<u>% Change from Prior Year</u>	<u>Calendar 2007 Estimated</u>	<u>% Change from Prior Year</u>
<u>United States</u>							
Real Gross Domestic Product (Billions of 2000 dollars)	\$10,755.7	\$11,134.8	3.5%	\$11,508.5	3.4%	\$11,814.2	2.7%
Implicit Price Deflator GDP (2000 = 100)	109.1	112.1	2.8%	115.7	3.2%	119.1	3.0%
Consumer Price Index (1982-84 = 100)	188.9	195.3	3.4%	201.5	3.2%	206.7	2.6%
Personal Consumption Deflator (2000 = 100)	108.2	111.3	2.8%	114.4	2.7%	116.8	2.2%
3-month Treasury Bills Interest Rate (Percent)	1.4%	3.1%		4.7%		4.9%	
Aaa Corporate Bonds Interest Rate (Percent)	5.6%	5.2%		6.1%		6.8%	
Unemployment Rate—Civilian (Percent)	5.5%	5.1%		4.8%		4.9%	
Light Vehicle Sales (Millions of units)	16.9	16.9	0.0%	16.7	-1.0%	16.8	0.6%
Passenger Car Sales (Millions of units)	7.5	7.7	2.0%	7.9	3.7%	8.0	1.0%
Light Truck Sales (Millions of units)	9.4	9.2	-1.6%	8.8	-4.9%	8.8	0.1%
Import Share of Light Vehicles (Percent)	20.2%	20.1%		22.0%		22.0%	
Personal Income (Billions of current dollars)	\$9,713.3	\$10,248.3	5.5%	\$10,929.0	6.6%	\$11,587.4	6.0%
Real Disposable Income (Billions of 2000 dollars)	\$8,004.1	\$8,120.3	1.5%	\$8,405.9	3.5%	\$8,718.8	3.7%
<u>Michigan</u>							
Wage and Salary Employment (Thousands)	4,394	4,387	-0.2%	4,342	-1.0%	4,316	-0.6%
Unemployment Rate (Percent)	7.0%	6.7%		6.8%		7.5%	
Personal Income (Millions of current dollars)	\$324,134	\$335,165	3.4%	\$347,961	3.8%	\$362,445	4.2%
Real Personal Income (Millions of 1982-84 dollars)	\$174,778	\$175,624	0.5%	\$176,276	0.4%	\$179,287	1.7%
Real Disposable Income (Millions of 1982-84 dollars)	\$156,305	\$155,640	-0.4%	\$156,055	0.3%	\$158,848	1.8%
Wage and Salary Income (Millions of current dollars)	\$180,252	\$186,722	3.6%	\$190,048	1.8%	\$195,874	3.1%
Detroit Consumer Price Index (1982-84 = 100)	185.4	190.8	2.9%	197.4	3.4%	202.2	2.4%
Detroit CPI (FY) (1982-84 = 100)	184.3	189.1	2.6%	196.1	3.7%	201.0	2.5%



RISKS AND UNCERTAINTIES

An economic forecast is based on the best information available at the time the forecast is made. Because information and foresight are not perfect, risks and uncertainties are inherent in any forecast. The key risks in this forecast stem predominantly from uncertainties surrounding energy prices, the housing market, monetary policy, and Michigan's motor vehicle industry.

Energy Prices

The average West Texas Intermediate crude oil price was \$63 per barrel in the third quarter of 2005—approximately \$14 per barrel higher than in the year-ago quarter. More recently, oil prices have averaged \$70 per barrel. Oil prices are forecast to remain elevated throughout CY 2006 and CY 2007, averaging \$67 per barrel in CY 2006 and \$64 per barrel in CY 2007. These prices are significantly higher than the previously-estimated long-term trend price of oil. Global supply constraints and increased world demand have contributed to the high oil prices.

Energy prices affect the economy primarily through allocation of disposable income—because more income is used for energy-related goods, less is used for all other items. Energy prices could fall below the estimated level—causing economic growth to be stronger than anticipated, or they may be higher than estimated—resulting in economic growth below the forecasted level.

Housing Market

National housing activity has remained exceptionally strong over the last several years. Over the last few years, consumer spending has been aided by refinancing activity on homes that have appreciated in value. Despite increases in short-term interest rates, long-term interest rates have not risen correspondingly—and housing prices have posted significant gains.

After a 10% increase in CY 2004, new and existing home sales increased approximately 5% in CY 2005. However, for the first three months of 2006, new home sales decreased 8% and existing home sales decreased approximately 1% from a year ago.

The housing market is expected to slow as interest rates continue to move higher. Consumer spending is expected to slow as the housing market cools in home sales and in refinancing activity. Consumption is forecast to grow 3.5% in CY 2006 and 3.3% in CY 2007.

Monetary Policy

The Federal Reserve (Fed) has increased short-term interest rates 16 times over the last two years. The federal funds rate was increased to 5.0% in May and is expected to increase another 25 basis points at the June meeting.

The key uncertainty surrounding monetary policy is whether or not the Fed will take additional action. Although higher oil prices and wage increases could cause higher inflation, the economy is expected to slow due to energy prices and the lagged effects of interest rate increases on the housing market.

Michigan's Motor Vehicle Industry

The level and composition of light motor vehicle sales is a key component of Michigan's economy. Light vehicle sales were 16.9 million units in CY 2005 and are forecast to be 16.7 million in CY 2006 before increasing slightly to 16.8 million in CY 2007. The import share of light vehicles was 20.1% in CY 2005, and is forecast to be 22.0% in both CY 2006 and CY 2007.

The market share of the big three auto manufacturers declined to an all-time low of 56.9% in CY 2005. Imports and vehicles with a foreign nameplate that are made in the U.S. (transplants) have steadily gained in market share over the past several years. The extent to which the domestic nameplates can hold on to market share will have a direct impact on Michigan's economy. This forecast assumes that the big three market share will decline by approximately 2% per year in both CY 2006 and CY 2007.

Michigan transportation employment is forecast to decline 8.5% in CY 2006 and 10.8% in CY 2007. If the Michigan-produced market share of motor vehicles is less than anticipated, Michigan's economy and revenue growth will be lower than estimated.



GF/GP AND SAF REVENUE

Revenue estimates are based on economic performance of the components of national and state economies discussed in the previous section. This section explains May 2006 House Fiscal Agency revenue estimates for GF/GP (**Table 5**) and SAF (**Table 6**) revenue by major revenue sources. It provides revenue estimates, year-end balances for the major funds and the budget stabilization fund, and the state revenue limit calculation.

GF/GP Revenue by Source

GF/GP Baseline Tax Revenue

Baseline GF/GP tax revenue totaled \$7,897.3 million in FY 2004-05; it is estimated to increase \$179.4 million (2.3%) to \$8,076.6 million in FY 2005-06, and \$147.4 million (1.8%) to \$8,224.1 million in FY 2006-07.

Total GF/GP Baseline Revenue

Total baseline GF/GP revenue includes baseline tax revenue and non-tax revenue such as federal aid, licenses and permits, and transfers from the liquor purchase revolving fund. Total GF/GP baseline revenue was \$8,163.4 million in FY 2004-05; it is estimated to increase \$8,319.1 million (1.9%) in FY 2005-06, and \$139.4 million (1.7%) to \$8,458.6 million in FY 2006-07.

Actual GF/GP Revenue

Actual GF/GP revenue takes tax changes into account and is available for expenditure each year. Final actual GF/GP revenue was \$8,298.9 million in FY 2004-05; it is forecast to decline \$8.2 million (0.1%) to \$8,290.6 million in FY 2005-06, and increase \$109.0 million (1.3%) to \$8,399.7 million in FY 2006-07.

SAF Revenue by Source

Total SAF Baseline Revenue

Total SAF baseline revenue was \$10,914.7 million in FY 2004-05; it is forecast to increase \$266.1 million (2.4%) to \$11,180.8 million in FY 2005-06, and increase \$332.0 million (3.0%) to \$11,512.8 million in FY 2006-07.

Actual SAF Revenue

Actual SAF revenue takes tax changes into account. Actual SAF revenue totaled \$10,909.7 million in FY 2004-05; it is forecast to increase \$296.6 million (2.7%) to \$11,206.3 million in FY 2005-06 and \$330.0 million (2.9%) to \$11,536.3 million in FY 2006-07.

Table 5
GF/GP REVENUE ESTIMATES
(Millions of Dollars)

	Final			Fiscal Year 2006-07 over 2005-06	
	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>FY 2006-07</u>	<u>%Change</u>	<u>\$Change</u>
Personal Income Taxes	\$4,138.6	\$4,199.1	\$4,259.0	1.4%	\$59.9
Sales and Use Taxes	1,014.9	1,042.3	1,086.6	4.3%	44.3
SBT and Insurance Taxes	2,140.7	2,209.0	2,270.0	2.8%	61.0
Other Taxes	<u>603.1</u>	<u>626.2</u>	<u>608.4</u>	-2.8%	<u>(17.8)</u>
GF/GP Baseline Tax Revenue	\$7,897.3	\$8,076.6	\$8,224.1	1.8%	\$147.4
Non-Tax Revenue	<u>266.1</u>	<u>242.5</u>	<u>234.5</u>	-3.3%	<u>(8.0)</u>
Total GF/GP Baseline Revenue	\$8,163.4	\$8,319.1	\$8,458.6	1.7%	\$139.4
Adjustments to Baseline	<u>135.5</u>	<u>(28.5)</u>	<u>(58.9)</u>	-106.7%	<u>(30.4)</u>
Actual GF/GP Revenue	\$8,298.9	\$8,290.6	\$8,399.7	1.3%	\$109.0

NOTE: Numbers may not add due to rounding.

Table 6
SCHOOL AID FUND REVENUE ESTIMATES
(Millions of Dollars)

	Final			Fiscal Year 2006-07 over 2005-06	
	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>FY 2006-07</u>	<u>% Change</u>	<u>\$ Change</u>
Sales and Use Tax	\$5,273.0	\$5,357.6	\$5,554.2	3.7%	196.6
Income Tax Earmark	1,988.7	2,059.4	2,111.5	2.5%	52.1
State Education Tax	1,916.7	2,006.8	2,104.0	4.8%	97.2
Lottery/Casino Wagering	765.2	790.2	797.3	0.9%	7.1
Tobacco Taxes	472.7	472.7	463.3	-2.0%	(9.5)
Real Estate Transfer Tax	313.5	325.0	308.0	-5.2%	(17.0)
Other Taxes	<u>184.9</u>	<u>169.1</u>	<u>174.6</u>	3.3%	<u>5.5</u>
Baseline SAF Revenue	\$10,914.7	\$11,180.8	\$11,512.8	3.0%	\$332.0
Adjustments to Baseline	<u>(5.0)</u>	<u>25.5</u>	<u>23.5</u>	-7.8%	<u>(2.0)</u>
Actual SAF Revenue	\$10,909.7	\$11,206.3	\$11,536.3	2.9%	\$330.0

NOTE: Numbers may not add due to rounding.

HFA Estimates of Year-End Balances

Table 7 reports House Fiscal Agency estimates of year-end balances for GF/GP, the SAF, and the BSF.

Fiscal Year 2005-06 estimates are based on year-to-date appropriations and HFA revenue estimates. Final FY 2003-04 and FY 2004-05 figures are included.

Budget Stabilization Fund estimates are based on current balance estimates provided by the Michigan Department of Treasury and HFA estimates of future deposits and interest earned.

Table 7
YEAR-END BALANCE ESTIMATES
(Millions of Dollars)

	<u>Final</u> <u>FY 2003-04</u>	<u>Final</u> <u>FY 2004-05</u>	<u>Estimated</u> <u>FY 2005-06</u>
General Fund/General Purpose	\$0.0	\$220.5	\$164.8
School Aid Fund	\$74.1	\$98.0	\$97.1
Budget Stabilization Fund	\$81.3	\$2.0	\$0.0

School Aid Fund revenues are restricted; any year-end balance is carried forward to the subsequent year.

BSF Year-End Balance

The Counter-Cyclical Budget and Economic Stabilization Fund (BSF), the state's rainy day fund, is a reserve of cash to contribute to or withdraw from throughout economic and budget cycles. **Table 8** details deposits, withdrawals, interest earnings, and the year-end balance from FY 1990-91 through FY 2006-2007. **Figure 9** shows the BSF fund balance and the BSF fund balance as a percent of total GF/GP and SAF revenue.

FY 2004-05

Based on final FY 2004-05 data, \$81.3 million was transferred from the BSF to GF/GP. The BSF ending balance was \$2.0 million.

FY 2005-06 and FY 2006-07

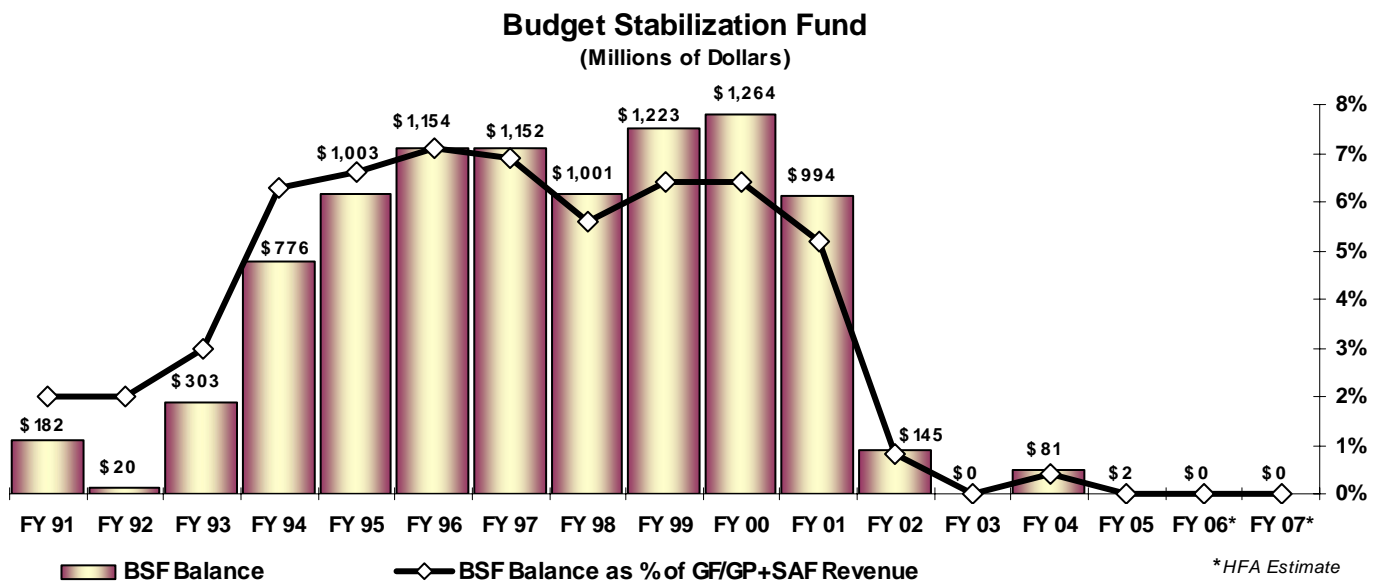
The BSF trigger calculation, which is based on Michigan personal income less transfer payments adjusted for inflation and actual or net GF/GP revenue, indicates a withdrawal of \$50.4 million for FY 2005-06 and no pay-in or withdrawal for FY 2006-07. Pay-ins to the BSF are subject to an appropriation.

Table 8
BUDGET STABILIZATION FUND HISTORY
(Millions of Dollars)

<u>Fiscal Year</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Interest Earned</u>	<u>Balance</u>
1990-91	0.0	230.0	27.1	182.2
1991-92	0.0	170.1	8.1	20.1
1992-93	282.6	0.0	0.7	303.4
1993-94	460.2	0.0	11.9	775.5
1994-95	260.1	90.4	57.7	1,003.0
1995-96	91.3	0.0	59.2	1,153.6
1996-97	0.0	69.0	67.8	1,152.4
1997-98	0.0	212.0	60.1	1,000.5
1998-99	244.4	73.7	51.2	1,222.5
1999-2000	100.0	132.0	73.9	1,264.4
2000-01	0.0	337.0	66.7	994.2
2001-02	0.0	869.8	20.8	145.2
2002-03	0.0	156.1	10.9	0.0
2003-04	81.3	0.0	0.0	81.3
2004-05	0.0	81.3	2.0	2.0
2005-06*	0.0	2.0	0.0	0.0
2006-07*	0.0	0.0	0.0	0.0

* HFA Estimates NOTE: Numbers may not add due to rounding.

Figure 9



Compliance With the State Revenue Limit

Article IX, Section 26 of the *Michigan Constitution*, which was approved by the vote of the people in 1978, sets a limit on the amount of revenue collected by the state in any fiscal year. As provided for in the Constitution, the revenue limit is calculated as 9.49% of total state personal income (which is the broadest measure of state economic activity) in the previous full calendar year prior to the fiscal year in which the revenues are measured.

The revenue to be considered in the revenue limit includes not only state taxes, but also fees, licenses, and interest earned. Federal aid is not included in the revenue limit calculation. Article IX, Section 26, *Constitution of the State of Michigan*, provides that:

. . . For any fiscal year in the event that Total State Revenues exceed the limit established in this section by 1% or more, the excess revenues shall be refunded pro rata based on the liability reported on the Michigan income tax and single business tax (or its successor tax or taxes) annual returns filed following the close of such fiscal year. If the excess is less than 1%, this excess may be transferred to the State Budget Stabilization Fund

Furthermore, the state is prohibited from spending any current-year revenue in excess of the limit established in Section 26 by Article IX, Section 28.

As shown in **Table 9**, **Table 10**, and **Figure 10**, the final FY 2003-04 revenue limit calculation indicated that state revenue collections were \$4.44 billion below the revenue limit. For FY 2004-05, FY 2005-06, and FY 2006-07, state revenue is estimated to be substantially below the revenue limit—by \$4.22 billion, \$4.79 billion, and \$5.28 billion, respectively.

Table 9
COMPLIANCE WITH THE STATE REVENUE LIMIT
(Millions of Dollars)

<u>Revenue Limit Calculations</u>	<u>Final FY 2003-04</u>	<u>Estimated FY 2004-05</u>	<u>Estimated FY 2005-06</u>	<u>Estimated FY 2006-07</u>
Personal Income				
Calendar Year	<u>CY 2002</u>	<u>CY 2003</u>	<u>CY 2004</u>	<u>CY 2005</u>
Amount	\$303,745	\$314,460	\$324,134	\$335,165
X Limit Ratio	<u>9.49%</u>	<u>9.49%</u>	<u>9.49%</u>	<u>9.49%</u>
State Revenue Limit	\$28,825.4	\$29,842.3	\$30,760.3	\$31,807.1
Total Revenue Subject to Revenue Limit	<u>24,384.7</u>	<u>25,626.8</u>	<u>25,973.4</u>	<u>26,523.3</u>
Amount (Under) Over State Revenue Limit	(\$4,440.7)	(\$4,215.5)	(\$4,787.0)	(\$5,283.9)

NOTE: Numbers may not add due to rounding.

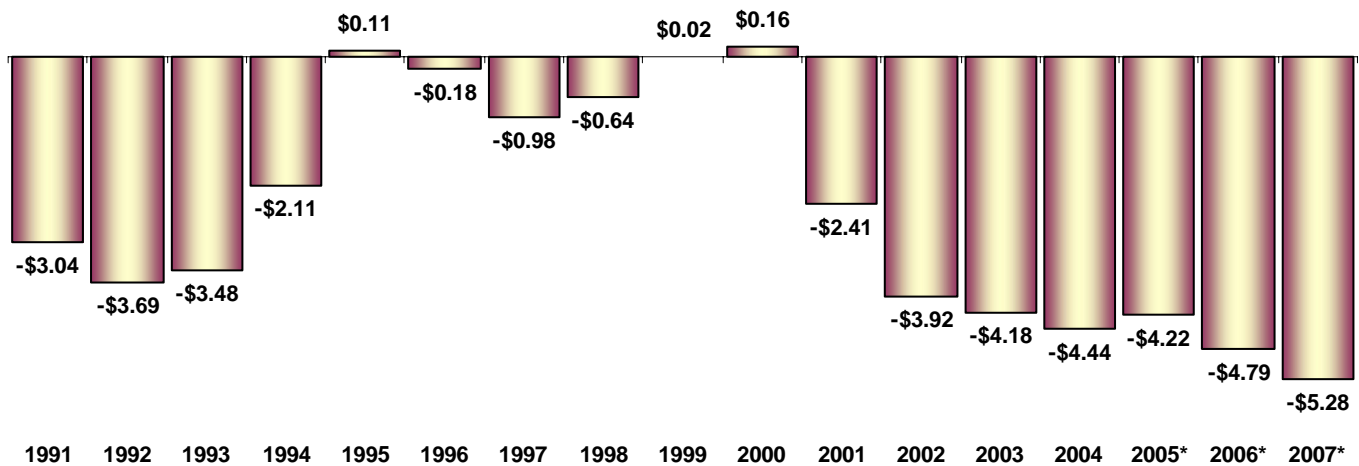
Table 10
CONSTITUTIONAL REVENUE LIMIT HISTORY
 (Billions of Dollars)

<u>Fiscal Year</u>	<u>(Under) or Over Limit</u>
1990-91	(\$3.04)
1991-92	(\$3.69)
1992-93	(\$3.48)
1993-94	(\$2.11)
1994-95	\$0.11
1995-96	(\$0.18)
1996-97	(\$0.98)
1997-98	(\$0.64)
1998-99	\$0.02
1999-2000	\$0.16
2000-01	(\$2.41)
2001-02	(\$3.92)
2002-03	(\$4.18)
2003-04	(\$4.44)
* 2004-05	(\$4.22)
* 2005-06	(\$4.79)
* 2006-07	(\$5.28)

*HFA Estimate

Figure 10

Constitutional Revenue Limit
 Amount Under or Over Limit (Billions of Dollars)



*HFA Estimate



Additional copies of this report can be obtained from:

House Fiscal Agency
P.O. Box 30014
Lansing, MI 48909-7514
(517) 373-8080
FAX (517) 373-5874
www.house.mi.gov/hfa